

Internal Revenue Service

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Third Party Communication: None

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Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-103151-16

Date:

July 22, 2016

LEGEND:

X =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Years =

Dear

This responds to a letter dated January 14, 2016, and supplemental information, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. X filed a timely election under § 1362(a) to be taxed as an S corporation effective Date 2. On Date 2, Trust 1, Trust 2, Trust 3, Trust 4, and Trust 5 (the "Group One Trusts") owned shares of X stock. X represents that the Group One Trusts were qualified to be Electing Small Business Trusts (ESBTs), but their common trustee failed to make ESBT elections for each of the trusts. Consequently, the Group One Trusts were ineligible shareholders, and, as a result, X's S corporation election was ineffective.

Additionally, on Date 2, A, an individual, owned shares of X stock. Beginning Date 3, A contributed shares of X stock to Trust 6, Trust 7, Trust 8, Trust 9 and Trust 10 (the "Group Two Trusts") during each of the calendar Years. X represents that the Group Two Trusts are eligible to elect to be treated as QSSTs, but their respective beneficiaries failed to make timely QSST elections effective Date 3. Thus, X's S corporation election would have terminated on Date 3 (if it had not already made an ineffective election) because the Group Two Trusts were ineligible shareholders.

Each of the five Group Two Trusts has the same beneficiary as its corresponding Group One Trust. Effective Date 4, the Group One Trusts merged with and into the Group Two Trusts established for the benefit of the same beneficiary, with the Group Two Trusts being the surviving trusts in the merger.

X represents that the circumstances resulting in the ineffectiveness and potential termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for X. X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Law and Analysis

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for the purposes of § 1362(b)(1)(B), a trust all of which is treated (under title 26, subtitle A, chapter 1, subchapter J, part I, subpart E of the United States Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(v) provides that an ESBT, within the meaning of § 1361(e)(1), may be a shareholder for purposes of § 1361(b)(1)(B).

Section 1361(d)(1) provides that, in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), (A) such trust will be treated as a trust described in § 1361(c)(2)(A)(i), and (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary; the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust. The trustee of the trust makes the ESBT election pursuant to § 1361(e)(3). Section 1.1361-1(m)(2)(i) provides that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the tax year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representation made, we conclude X's S election was ineffective for the taxable year beginning Date 2 upon the failure to timely file ESBT elections for the Group One Trusts. Accordingly, X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided that its S corporation election was otherwise valid and was not otherwise terminated under § 1362(d), excepted as addressed below. Each of the Group One Trusts will be treated as an ESBT from Date 2 until their merger with and into their corresponding Group Two Trust on Date 4, provided the trustee files an ESBT election for each Group One Trust with the appropriate service center, effective Date 2, within 120 days of the date of this letter. A copy of this letter should be attached to each ESBT election.

We further conclude that X's S corporation election would have terminated on Date 3 due to the failure to timely file QSST elections for the Group Two Trusts had the initial S election been valid. We also conclude that such termination would have constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 3, and thereafter, provided that its S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). The Group Two Trusts will be treated as QSSTs from Date 3 and thereafter, provided the income beneficiaries of the Group Two Trusts file a QSST election for their respective Group Two Trust effective Date 3 within 120 days from the date of this letter. A copy of this letter should be attached each QSST election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning the eligibility of X to be an S corporation.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

David R. Haglund

David R. Haglund
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: